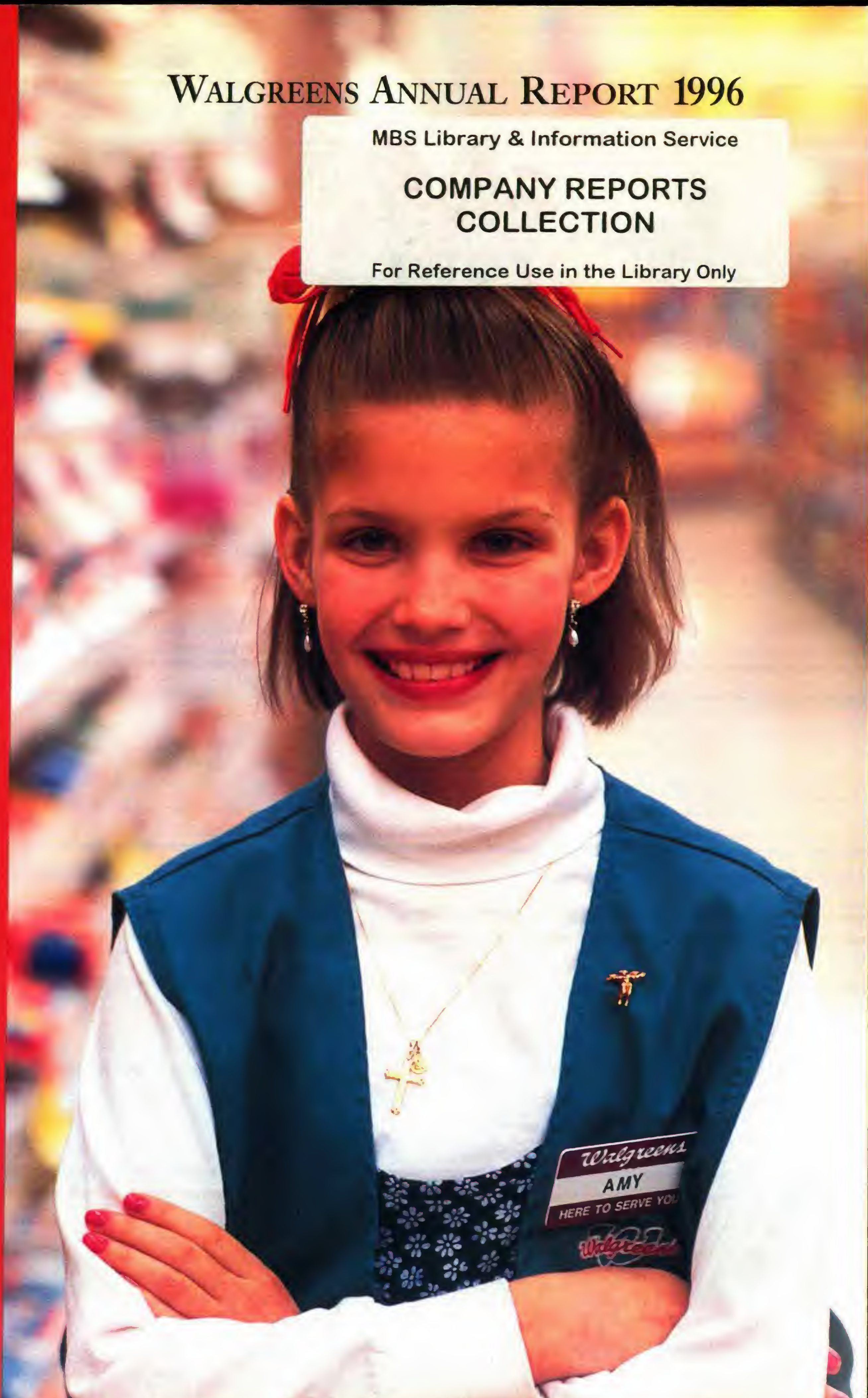
Walgreens Annual Report 1996

A Special Story…

A Special Store



Amy Lyon has a special connection to employees at the Tinley Park, Illinois, Walgreens. More than special. Behind the bright 10-year-old on our cover stretch two years of aggressive treatment for malignant brain and spinal cord tumors. While Amy's prognosis has improved, the Lyon family has endured a roller-coaster ride of despair, heartache and –

most of all – hope since the original diagnosis gave Amy less than a year to live. "Part of the healing our daughter needed came from your pharmacy," Sue Lyon told us recently. "An equal part came – and is still coming – from the people in that store." *Turn to page 4 for "A Special Story ... A Special Store."*

Walgreen Co. is the leader of the U.S. chain drugstore industry in sales, profits, store growth and technology use, and fills more prescriptions than any other American retailer. Our company's strategy is to be the nation's most convenient healthcare provider. Sales for 1996 reached $11.8 billion, produced by 2,193 drugstores in 34 states and Puerto Rico. Founded in 1901, Walgreens today has 77,000 employees and 38,000 shareholders of record. Our drugstores serve 2.2 million customers daily and average $5.2 million in annual sales per unit. That's $520 per square foot, among the highest in the industry. Walgreens is guided by a conservative fiscal policy and dedicated to aggressive growth. We've paid dividends in every quarter since 1933 and have raised them in each of the past 20 years.

10-Year Walgreen Stock Performance

On August 31, 1986, 100 shares of Walgreen stock sold for $3,550. Ten years later, on August 31, 1996, those 100 shares, having split twice, were 400 shares worth $13,150, for a gain of 270%.

Walgreens 1996 Highlights

- Walgreens opened a record 210 stores in 1996, 76 of which were relocations to better sites. Over half the chain — 1,150 stores — was freestanding at the end of the fiscal year. The average age of a Walgreen store today is 7.4 years, about *half* what it was 10 years ago.
- Walgreens filled nearly 190 million prescriptions in fiscal 1996 — more than 8% of the retail market.
- *WHP Health Initiatives,* Walgreens PBM (pharmacy benefits manager), increased sales 45%, to $330 million. Its two mail service facilities dispensed more than 3.6 million prescriptions in fiscal 1996 — over 12,000 every day.
- Drive-thru prescription service is now offered in more than 500 Walgreen pharmacies across the country.
- Walgreens market capitalization grew from $110 million in 1976 to $8 billion at August 31, 1996.
- For the third consecutive year, Walgreens was included on *Fortune* magazine's "Most Admired Corporations in America" list. *Fortune* ranks Walgreens as the 123rd largest company in America.
- Walgreens is one of only 35 companies to be listed in all four editions of *The 100 Best Stocks to Own in America,* by Gene Walden.

Financial Highlights

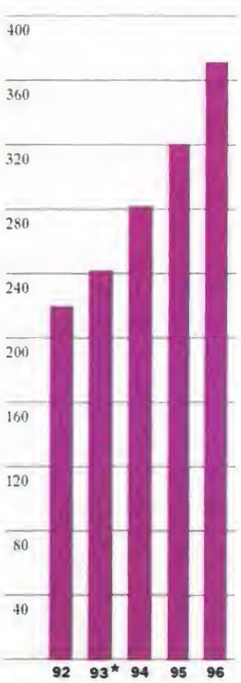
Per share data have been adjusted for a two-for-one stock split distributed to shareholders August 8, 1995.

For the Years Ended August 31, 1996 and 1995 (Dollars in Thousands, except per share data)	1996	1995	Increase
Net Sales	$11,778,408	$10,395,096	13.3%
Earnings Before Income Tax Provision	606,937	523,741	15.9%
Income Tax Provision	235,188	202,950	
Net Earnings	$ 371,749	$ 320,791	15.9%
Net Earnings per Common Share	$ 1.50	$ 1.30	15.4%
Shareholders' Equity	$ 2,043,105	$ 1,792,586	14.0%
Return on Average Shareholders' Equity	19.4%	19.1%	
Book Value per Common Share	$ 8.30	$ 7.28	14.0%

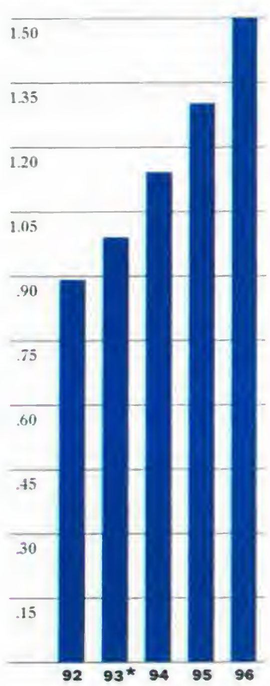
Dividend and Market History, Fiscal 1996 and 1995

	Dividends Declared		Common Stock Prices			
	1996	1995	1996		1995	
3 months through			High	Low	High	Low
November	11c	9¾c	$31¼	$24½	$21 3/16	$18½
February	11	9¾	36⅜	28½	24	20¼
May	11	9¾	34⅞	30⅞	24 13/16	22 13/16
August	11	9¾	34⅞	30¾	26 9/16	23⅝
Fiscal Year	44c	39c	$36⅜	$24½	$26 9/16	$18½

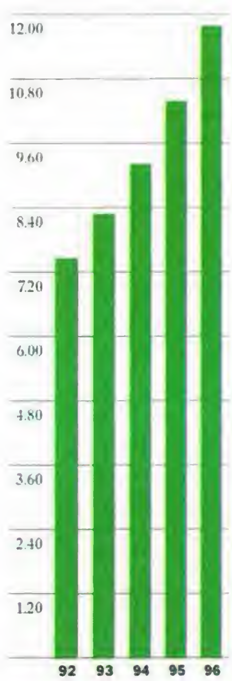
Earnings
Millions of Dollars



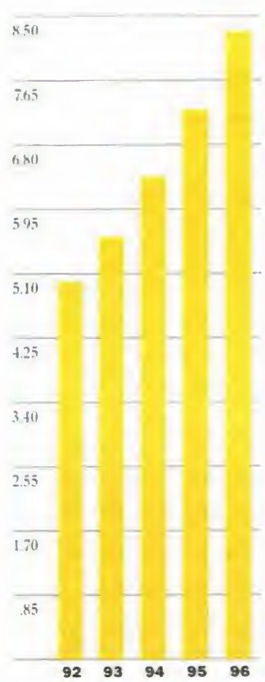
Earnings per Share
Dollars



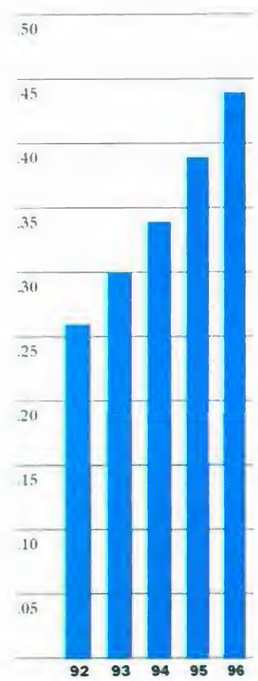
Sales
Billions of Dollars



Shareholders' Equity
Dollars per Share



Dividends Declared
Dollars per Share



* *Before accounting changes.*

Yes, it *is* possible to do well while doing good! We dramatically re-learned that this year from Amy and Sue Lyon and their special relationship with a Walgreen store in Tinley Park, Illinois. This story demonstrates how compassion and concern for others can blend perfectly with running an outstanding drugstore. While you review the positive results of your company in this report, we think you'll enjoy learning more about the remarkable Lyon family ... and their favorite Walgreens.

When the 1996 year-end figures were compiled, your company had done it once again. Walgreens had attained its 22nd consecutive year of record sales and earnings. This combination of higher sales and earnings every year for over two decades — together with 20 years of increased dividends — ranks Walgreens among an elite group of American companies.

Sales rose 13.3% to $11.8 billion for the year and those all-important net earnings did even better — they advanced 15.9% to $372 million or $1.50 per share.

Higher sales and earnings every year for over two decades – plus 20 years of increased dividends – ranks Walgreens among an elite group of American companies.

Strong in-stock conditions, better advertising and highly convenient store locations — and relocations — were a big boon to sales throughout the store. Overall, comparable store sales (in those units open at least one year) were up 8.5%, well above the rate of inflation and indicating real growth in both general merchandise and in the pharmacy.

Pharmacy — Another Banner Year

Walgreen pharmacists were fully engaged during the year, dispensing nearly 190 million prescriptions and maintaining Walgreens position as the preeminent — meaning *the largest and fastest growing* — prescription provider in America.

Pharmacy had another excellent year, growing 18% and contributing 45% of total sales. Despite low inflation, prescription sales in comparable stores increased a very healthy 13% for the year.

We continued rollout of our new, advanced pharmacy system, *Intercom Plus*, during the year. *Intercom Plus* speeds the prescription-filling process, permits us better patient counseling and — when operating in all stores next spring — will be the benchmark for pharmacy systems in our industry.

It was also a busy year for our real estate, construction and operations people as our robust expansion pace continued. A record 210 new Walgreen drugstores across the country opened their doors in a broad variety of markets, including Dallas/Fort Worth; Philadelphia; Richmond, Virginia; Las Vegas; Portland, Oregon; and Springfield, Missouri, all new cities for Walgreens.

Accelerated Expansion

Expansion will pick up even more in fiscal 1997, when we anticipate opening at least 230 new drugstores, including Walgreen stores in Detroit and Kansas City. By 1998 we plan to be opening 300 new stores a year, and be on target to have 3,000 Walgreens operating across the country by the new century.

Managed care already accounts for two-thirds of all retail prescriptions in the U.S. Our decades of pharmacy experience, our dedicated pharmacists, our huge base of retail prescriptions and our more than 2,000 pharmacies across the country help Walgreens add real value for healthcare payers.

Charles R. Walgreen III (left) and L. Daniel Jorndt

Maintaining Leadership

Your company has invested more than $1.2 billion over the past five years in new and relocated stores, as well as new systems and distribution centers, to assure that Walgreens remains the leading drugstore chain in America. This year's capital spending budget is targeted at more than $400 million.

Our balance sheet is strong and our financial condition excellent. The Board of Directors again voted a dividend increase, though of a more moderate amount to provide more cash for accelerated growth. This growth, in turn, will aid our long-term viability and optimize the potential for Walgreen stock appreciation. The December quarterly dividend will be 12 cents per share, an increase of 9.1% to a rate of 48 cents yearly.

Walgreens was again named one of *America's Finest Companies* – and one of only 65 publicly-traded companies in the U.S. with at least 10 straight years of higher earnings and dividends per share, according to the book by Bill Staton. We're gratified with our results last year and with the overall strength of our company and its retailing sector. We sincerely thank each and every one of our 77,000 employees for their fine contributions. With them we look forward to another successful year for Walgreens.

C.R. Walgreen III
Chairman

L. Daniel Jorndt
President

A Special Story

A Special Store

When you grow up in Chicago, "going to the drugstore" usually means "going to Walgreens." That's the way it was for Sue Lyon. "My sister and I practically lived in your store at 87th and Harlem," recalls the 36-year-old mother of three. "Especially in the summer. I have great memories of buying pints of ice cream... then sitting out on the curb to eat it right out of the carton."

Johnny, Amy and Mallory Lyon, summer 1996.

When Sue and her husband, John, were building a home in Tinley Park, Illinois, they were delighted to find a new Walgreens within throwing distance. *"Literally,"* says Sue. "It's just at the edge of our back yard. Right away the kids were running over to pick things up. You were such a plus to the neighborhood."

Just how *big* a plus, they would soon discover.

"Something really bad is wrong"

Shortly after their move — in May 1994 — the Lyons' eight-year-old daughter, Amy, came down with what seemed like the flu. *It wasn't.* "John and I were frantic," says Sue. "For two weeks, Amy got worse and worse and no one could tell us what was wrong."

"It was 11:15 p.m. when I realized I'd forgotten to pick up Amy's prescription...

...without it, I knew she'd be up in a few hours with severe vomiting. I called store manager Colleen Hayes at home and five minutes later pharmacist Bob Wilsak was pulling into our driveway. He'd been

Pharmacy manager Bob Wilsak

working late and volunteered to drive it over. We are deeply grateful for his kindness during a very difficult time in our lives." — *Sue Lyon*

Sue and John Lyon say goodbye at Chicago's O'Hare airport before the flight to Memphis for daughter Amy's June 1996 check-up at St. Jude Children's Research Hospital.

Her eyes still water when she recalls the night her daughter lay on the floor screaming in agony, "My head is cracking. You've got to help me! Something really bad is wrong."

"Something really bad" was finally diagnosed June 4. After numerous hospitalizations, three surgeries and weeks of tests, an MRI revealed a brain stem tumor — later identified as ependymoma —which had spread throughout Amy's spine. The prognosis was devastating: She was given three months to a year to live.

That horrible day plunged the Lyons into a two-year medical drama from which they are just now emerging... cautiously victorious. *Yes,* Amy is better — much better. Her quick smile, zest for life and the photos on these pages belie a seven-hour brain surgery followed by grueling months of chemotherapy and massive radiation... so massive doctors at St. Jude Children's Research Hospital in Memphis doubted she would survive it.

"Before she had cancer, Amy was an independent, 'I-can-do-anything' little girl...

... then came the dark days when she'd beg me not to leave her side. Thanks to Colleen and her staff, the original Amy is back. At her lowest ebb, they gave her confidence. When

Pharmacist Annette Bianchi

we came home from St. Jude's, Walgreens was the first place she stayed without me... being part of that store was a big step to giving Amy her life back." — *Sue Lyon*

St. Jude nurses prepare Amy for tests. This summer an MRI revealed the brain tumor had disappeared. "Miracles happen when you're surrounded by love," says Sue Lyon.

"We were told to prepare for a noticeable IQ drop, loss of sight, and leg muscle damage so severe it would leave her unable to walk," remembers Sue. "Miraculously, none of that happened."

While doctors haven't used the word "remission" yet, tests in June found that Amy's brain tumor has disappeared, while the spinal tumors have shrunk significantly. "There's still a long road ahead," says an elated Sue Lyon. "Anyone touched by cancer knows every day is a gift, but for the first time, physicians at St. Jude's are talking positively about the future."

"Doing well by doing good"

The past two years have irrevocably changed the lives of Sue, John, Amy, Johnny and Mallory Lyon... *and* those of Walgreen store manager Colleen Hayes and her 25 employees.

This is their story. We're not saying it happens like this in every store. But then, as your mother used to say, we're not *talking* about everybody else. This is the story of *one* Walgreens... where a group of employees seized the opportunity to help in ways which ultimately, claims Sue Lyon, "gave my daughter back her independence."

Colleen Hayes, a 10-year manager who started with Walgreens in high school, debunks the myth that 'heart' and profitability can't go hand in hand. Her Tinley Park store consistently performs above expectations and Colleen was named "Manager of the Year" for her district in 1995.

"If my employees and I are successful," says the 32-year-old, "it's because we treat each other — and our customers — with respect. Yes, we're part of a big company. But, every bit as important, we're part of our neighborhood."

Amy and Walgreen cosmetician Julie Wilkens are "best buddies," says Sue Lyon. The 10-year-old spends several hours a week in the Tinley Park store "helping out" and offering her homemade balloon puppies to young customers.

"Guardian Angels"

Colleen first heard of the Lyons' tragedy at church, when parishioners were asked to pray for Amy. "When I told my employees, everybody had the same question: 'How can we help?'"

They started small — taking a few toys over to the Lyons' home... and ended big — making Amy an honorary store employee. Midway through her ordeal, Sue Lyon wrote a letter of gratitude to Walgreen president Dan Jorndt.

"From the start, your employees have been our guardian angels," she said. "They're like family — dropping by the house on their breaks, sending packages to us at St. Jude's, donating time and money to the fund-raiser our friends arranged.

"Many times our 11-year-old son has run up to Walgreens for a little gift when Amy was having a bad day. They won't admit it, but we know your cashiers have personally supplemented Johnny's piggy bank.

"Mr. Jorndt, you can buy anything, anywhere... but Colleen and her staff make Walgreens where you *want* to shop."

"You were the first step"

"Before Amy got sick, she was a confident, 'I-can-do-anything' little girl," says her mother. "But during the months at St. Jude's, she grew very dependent on me. When we finally came home, we both had a hard time letting go. Giving Amy a somewhat normal life was my next big struggle. Then Colleen had a great idea."

"I knew Amy was comfortable in our store," explains the manager. "One day she and Sue came in to pick up a prescription and Amy asked if she could stay for a bit. I told Sue, 'Why not... we'll let her help out stocking the shelves.'

"Ever since, Amy's spent several hours a week here. We gave her a smock and a nametag and call her 'our littlest employee.'"

"Amy has a lot of her bounce back thanks to Walgreens," says Sue. "Your staff gave her a sense of belonging... an identity outside the hospital and her family. After this break-through, we coaxed Amy back to school. You were the first step.

"You know," she adds. "You can't do this alone. You *think* you can, but you *can't*."

Amy Lyon, back in the classroom last spring with fellow students at St. Alexander's School.

"No matter what happens, I'm not afraid"

Sue Lyon uses the word "miracle" often... and not lightly. "God has carried us," she says. "Without our faith, I don't know what would have happened. Every time we pray for hope, a door opens. And faith has given Amy the courage to endure so much pain... with such calmness and strength.

"All this could have been three times worse if she had fought the treatment. Amy's never asked, *'Why me?'* She's never been angry, though she has every right to be. 'Mom,' she says, 'no matter what happens, I'm not afraid.'

"Since Amy became ill, there have been so many miracles in our lives. Most important, of course, was the day we walked through the doors of St. Jude's. Doctors there offered hope when we'd been told to take her home and make her comfortable for the little time she had left.

"But there are countless other people who've met a need, often before we realized it ourselves. Air-conditioning was installed in our house so Amy would be more comfortable... we still don't know who paid for that.

Sue Lyon with daughter, Amy.

"Part of the healing Amy needed…

…came from the medicine behind your Tinley Park pharmacy counter.

Assistant manager Derek Buerger

An equal part came – and is still coming – from the concern and prayers… the love and laughter… the friendship… offered in that store."

— Sue Lyon

"While Amy was under intense treatment, plane tickets appeared in our mail box, allowing John, Johnny and Mallory to spend Thanksgiving 1994 with Amy and me at St. Jude's.

"And your pharmacist, Annette Bianchi, arranged with friends to decorate Amy's room. They knew she'd be in bed much of the time and decided to 'bring the outside in' by hand-painting the ceiling and walls with trees, flowers and clouds. It's just beautiful.

"A friend of mine," adds Sue, "may have explained it best: *'Coincidence,'* he told me one day, *'is God's way of remaining anonymous.'*

"Walgreens is one of our many 'coincidences.'"

A Special Store

Operations Review

A group of energetic five-year-olds will blow out the candles on Walgreens 100th birthday cake in 2001. The 'honorees'? Our 3,000 drugstores, projected to average just 5.7 years of age as we enter our second century of business.

That's the major story of the 1990s for Walgreens: the renewal of our entire store base. Ten years ago, our average store was more than 14 years old. It's half that today and will continue to decline as we add and relocate stores across the country. "What we're doing," says Chairman Charles R. Walgreen III, "is changing the face of Walgreens."

As we closed fiscal 1996, more than half our drugstores — 1,150 — were already freestanding, a concept Walgreens pioneered. This has been accomplished primarily since 1991, the year we made the decision to enter a new market — Indianapolis — by developing freestanding, in-the-neighborhood sites with drive-thru pharmacy, rather than by acquiring 'instant' market-share via acquisition.

Walgreens is the leader in the development — and rapid rollout — of innovative drugstore concepts. "The key, however,

Tinley Park, Illinois, store manager Colleen Hayes.

"If Colleen Hayes ran for mayor of Tinley Park, she'd be elected... she's <u>that</u> tied to her community. Committed store managers like Colleen are a major Walgreen strength in neighborhoods across America." — Dan Jorndt

Colleen Hayes runs her store with 'heart' <u>and</u> 'head.' Since it opened in 1992, she's increased sales and profits 25% to 35% each year, surpassing all goals. "You keep thinking the store has reached its potential," says district manager Gary Hannon, "and then sales explode all over again."

is *execution,"* says President Dan Jorndt. "Anyone can build stores and copy layouts. It's what happens at store level that builds profits. That's where experience — and high-quality local management — enter the picture. We have an abundance of *both*."

Tinley Park staff members include, from left: Dana Dercole, Carl DeLisi, Joan Rygula, Keith Janowski, Judy Zarate, Ruth Pappenfus, Sandy Kapadia, Mike Ambre.

Traci Bill selects merchandise using pick-to-light technology at Walgreens year-old distribution center in Woodland, California. We're also building a pick-to-light system for installation in our Orlando center in 1997. Advantages of this technology are increased productivity, high accuracy and ease of employee training.

Pretzels, Cappuccino and Southern Fried Chicken...

Philadelphia, Seattle and Richmond, Virginia, got their first taste of Walgreens in 1996. So did Dallas/Fort Worth ... *and* Las Vegas ... *and* Portland, Oregon ... *and* Springfield, Missouri. On deck for 1997 are Detroit and Kansas City.

Where is growth coming from? Three areas: overall prescription growth, consolidation within the industry and the decline of independent pharmacies, which are closing at the rate of more than six per day. Why does this business flow to Walgreens? In one word, *convenience.*

"We're invading our competition's strongest markets," says Jorndt. "And doing *well.* In our two-year-old Buffalo market, year-to-year sales in comparable stores are running up about 40%. Cleveland is seeing 25% gains, and Indianapolis, where we've had stores since 1992, is up more than 15%."

"Our company's underlying strength," adds Jorndt, "is that *despite* heavy costs for expansion in new and existing markets — *plus* retail systems development — our earnings are accelerating. Just in the last three years, for example, we've written off more than $70 million to close and relocate stores ... *and* remained essentially debt-free."

"Where we can make a store better, we do it. Even a great store. Next year, for example, we'll tear down our seven-year-old Linden, New Jersey, Walgreens and replace it with an oversized store. Sales are expected to climb more than 30%."

— Charles R. Walgreen III

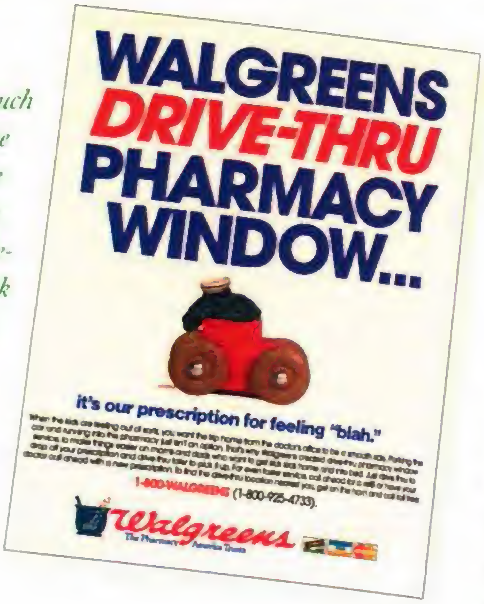
From the corner to the mall and back to the corner

A car dealer in Minnesota has extended service hours until midnight. "People want convenience," says the owner. "They don't want to wait a day for the car to be fixed."

"Mall Crawl Palls" is the headline on an *American Demographics* article reporting that a full third of adults shop at malls less frequently than they used to.

"The perimeter of my shopping world grows smaller," writes a California columnist in the *San Jose Mercury News.* "I've given up mall hopping and its driving traumas to resume shopping at stores close to home ... Walgreens is one of my favorites."

Walgreens has left not only the malls ... but also the large strip shopping centers. We've relocated 236 stores in the past five years, the vast majority to freestanding sites. On average, sales jump about 30% the first year a store is relocated. Initially, profitability is flat, but increases significantly in the second and succeeding years.



Localized ads, such as this one on the back cover of the Chicago Tribune TV guide, supplement once-a-week circulars which now reach 32 million households every Sunday.

More convenience? We now offer drive-thru service in more than 500 stores. "Our high pharmacy volume makes us very efficient with drive-thru," says Jorndt. "Staff-wise, it's a tough concept to afford — and manage — if you fill 125 prescriptions a day. The average Walgreen store dispenses about 250 per day." This productivity 'story' is true throughout our stores, which average sales per square foot of $520, among the highest in the industry.

At the top of a strong class

The chain drugstore industry Walgreens leads is a healthy one. Goldman Sachs analyst John Heinbockel forecast recently that, "Without question, the drugstore sector will continue to produce perhaps the strongest unit growth — *at about 5% to 6%* — of any retailing sector."

Demographics and cost containment underlie Goldman's prediction. The 50th birthday bash thrown for President Bill Clinton this summer symbolized the coming of age — of *prescription age,* that is — for the 78 million-member baby boom population, defined as people born between 1946 and 1964.

Sales are up 25% in this relocated store on Chicago's South Side. We doubled the size of the previous store, which opened on this corner in 1962.

This group will be — by *far* — the fastest-growing population segment over the next two decades. And as they age, they'll flock to pharmacies: people 55 and older consume *double* the prescriptions used by the population as a whole.

The *number* of prescriptions taken annually per person is also increasing — from 13 in 1993 to 17 in 1995 for those over 70 years of age. This reflects new drug development and healthcare cost consciousness, which lead to increased use of pharmaceutical therapy versus hospitalization and surgery.

Technology at Walgreens two-year-old Healthcare Plus mail service facility in Tempe, Arizona, will be significantly upgraded in 1997 to accommodate faster-than-anticipated growth.

An aging population also bodes well for sales — in close-to-home, easy-access retail outlets — of such items as over-the-counter drugs, skin-care products, home test kits and nutritional supplements. The miles of aisles in 'big box' mass merchandisers are *not* cane- and walker-friendly!

"Our Orlando and Tempe mail service facilities are equal to about 150 Walgreen stores in daily prescription dollar volume. Mail service sales volume grew 49% last year and is projected to reach half a billion dollars in 1998."

— Dan Jorndt

But what's managed care doing to margins?

Pushing them down, although Walgreens has been able to offset the decline through better expense controls. We've also stood firm behind the decision to reject unprofitable prescription plans, announced in late 1994 as our "line in the sand" program. While we've given up some managed care plans, we've renegotiated better rates with others.

Walgreens strong marketshare, geographic dispersion and the full line of services offered through our pharmacy benefits manager — *WHP Health Initiatives* — provide the leverage that increased third party prescription sales 25% last year. Close to 75% of our pharmacy business is now third party.

Overall, Walgreens fills more than 8% of all retail prescriptions in the United States, accounting for 45% of our business. Our mail service sales volume grew 49% last year and is projected to reach $500 million in fiscal 1998.

Other Walgreen PBM services include long-term care prescriptions, durable medical equipment, home infusion services and our Patient Care Center *(PCC)*. Through the PCC, we monitor overall pharmaceutical care, working first to improve quality for the patient, and then to lower costs for the managed care plan. We believe patient compliance presents the best opportunity to significantly impact both *quality* and *cost.* If patients are better educated in the use of their prescriptions, they will be lower users of higher-cost care.

Pharmacist Roger Ngo verifies a mail service prescription. Walgreens dispensed more than 3.6 million prescriptions last year at its Tempe and Orlando mail service facilities – that's over 12,000 every day.

Fewer ads = bigger sales

Sound impossible? Not for Walgreens… not in 1996.

Despite moving to one ad a week chainwide last January, comparable store sales (in stores open more than a year) climbed 8.5%, far outpacing inflation. Improvement is credited to excellent ads and improved in-stock conditions. The combination of new inventory systems plus "plain old-fashioned diligence" has cut out-of-stock items in half since February.

Sales were also boosted by the growing number of freestanding locations. We've found the more convenient we are, the less we need to advertise. Average sales per store have climbed almost 30% since 1991.

By scanning the prescription label, a Tempe pharmacist pulls up a computer screen which details precisely what should appear in the vial he is verifying.

What's next?

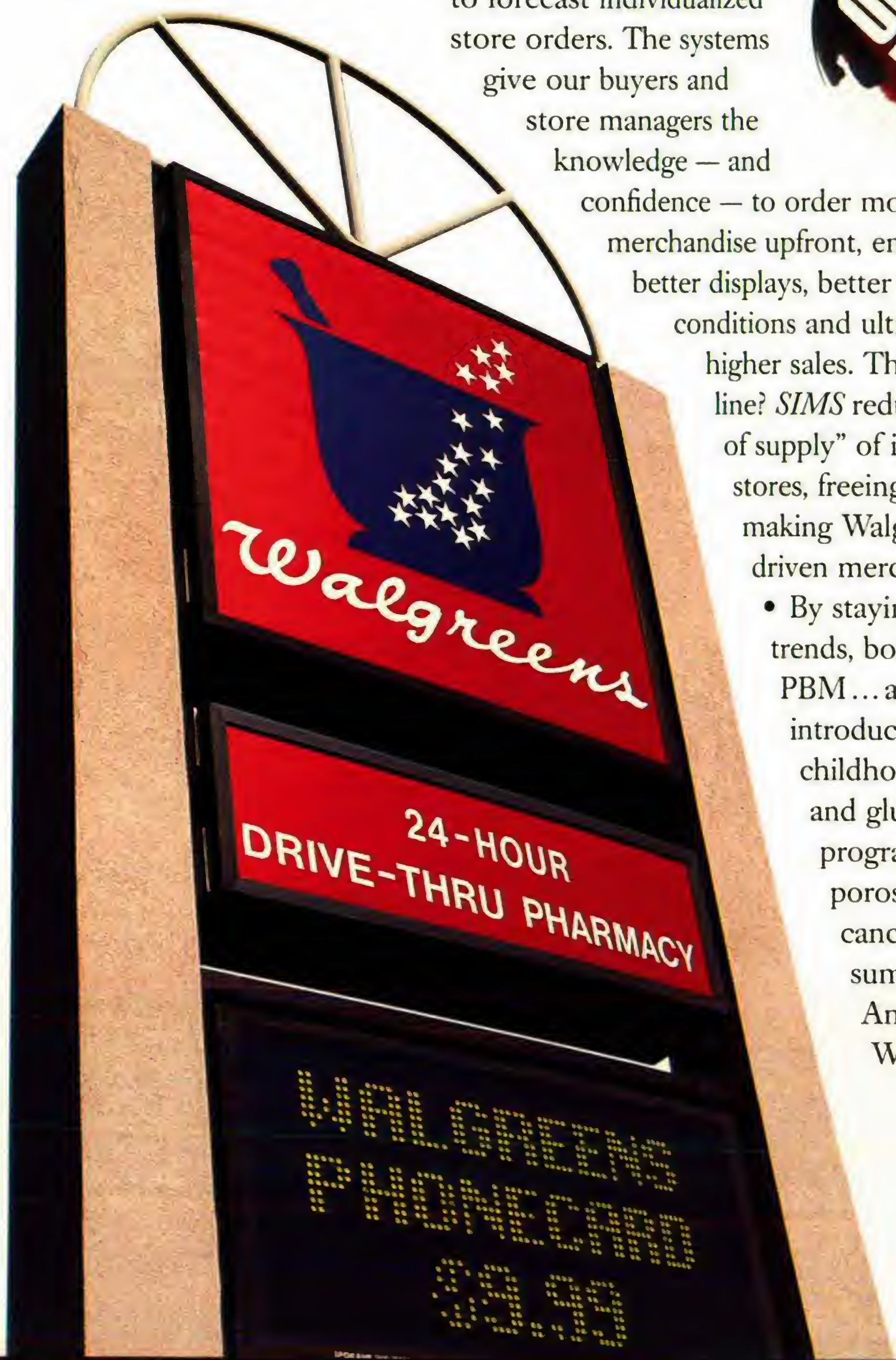
How does an old-line, conservative company approach its second century?

- By doing better what we do best: operating more — and *more convenient* — drugstores.
- By driving down operating expenses to improve profitability. In 1996, these costs dipped to 22.6% of sales, the lowest in our history. Taking credit are technology, distribution efficiencies, lower advertising costs, strict attention to payroll control and, of course, healthy sales volume.
- By forging ahead with technology, such as *Intercom Plus* and touch-tone refills, which will be in all pharmacies by next spring, and *SIMS,* our inventory management system.

To date, *SIMS* has saved over $200 million in warehouse inventory, more than *double* the cost of the entire project. Its 'crown jewels' are *PMM* (Promotional Merchandise Management) and store ad bulletins. Combined, they represent the most significant change for inventory management in our company's history.

Both use data from scanning — "our corporate cash register" — to forecast individualized store orders. The systems give our buyers and store managers the knowledge — and confidence — to order more merchandise upfront, encouraging better displays, better in-stock conditions and ultimately, higher sales. The bottom line? *SIMS* reduces "days of supply" of inventory in the warehouses and stores, freeing dollars to finance growth and making Walgreens a more powerful, sales-driven merchant.

We offer one-hour photofinishing in all new stores and are selectively converting existing markets to this service. We find 'one-hour' connotes a quality image which draws new customers and also increases 'next-day' photofinishing volume.



Electronic readerboard signs increase visibility for freestanding, on-the-corner sites, telling consumers Walgreens is there 'for the things you need right now.' More than half our drugstores were freestanding at the end of fiscal 1996.

- By staying on the cutting edge of healthcare trends, both *outside* the store, through our PBM ... and *inside* the store, through the introduction of services such as flu shots, childhood immunizations, blood pressure and glucose readings, and early detection programs for conditions including osteoporosis and colorectal and prostate cancer. All have met with broad consumer acceptance — nearly 200,000 Americans, for example, came to Walgreens for flu shots this fall.

Pharmacy manager Bill Buckner counsels a patient in Memphis, one of the first markets to be converted to Intercom Plus, our revolutionary workflow/computer system. Intercom Plus maximizes pharmacists' time . . . and patients' convenience. It will be chainwide in 1997.

Anyone can build stores and copy layouts. It's what happens at store level that builds profits . . . Success is in execution . . . people deliver great service.

The store is the product

"In retail," stated a recent Goldman Sachs report, "the *store* is the product."

"The retail industry is extremely sensitive to people . . . ," says Margaret Gilliam of CS First Boston. "When much of a retailer's superior productivity is due to a culture that engenders a highly motivated organization, no amount of money or capital investment in systems and procedures can make up the difference."

We at Walgreens find these observations very positive for our future. We believe what made us successful in 1901 will make us successful in 2001. "More than ever," says Charles R. Walgreen III, "despite the technological revolution, our competitive edge is the service and professionalism of our employees. Success is in execution . . . *people* deliver great service." ■

Moving Right Along

New markets in 1996-97 include:

Dallas/Fort Worth
Detroit
Kansas City
Las Vegas
Philadelphia
Portland, Oregon
Richmond, Virginia
Springfield, Missouri

Eleven-Year Summary of Selected Consolidated Financial Data

Walgreen Co. and Subsidiaries
(Dollars in Thousands, except per share data)

	Fiscal Year	1996	1995	1994
Net Sales		$11,778,408	$10,395,096	$9,234,978
Costs and Deductions	Cost of sales	8,514,819	7,482,344	6,614,445
	Selling, occupancy and administration	2,659,525	2,392,731	2,164,889
	Other (income) expense *(1)*	(2,873)	(3,720)	(2,777)
	Total Costs and Deductions	11,171,471	9,871,355	8,776,557
Earnings	Earnings before income tax provision and cumulative effect of accounting changes	606,937	523,741	458,421
	Income tax provision	235,188	202,950	176,492
	Earnings before cumulative effect of accounting changes	371,749	320,791	281,929
	Cumulative effect of accounting changes *(2)*	—	—	—
	Net Earnings	$ 371,749	$ 320,791	$ 281,929
Per Common Share *(3)*	Earnings before cumulative effect of accounting changes	$ 1.50	$ 1.30	$ 1.14
	Net Earnings *(2)*	1.50	1.30	1.14
	Dividends Declared	.44	.39	.34
	Book Value	8.30	7.28	6.39
Non-Current Liabilities	Long-term debt	$ 3,403	$ 2,395	$ 1,790
	Deferred income taxes	145,218	142,278	137,741
	Other non-current liabilities	259,965	237,586	213,796
Assets and Equity	Total Assets	$ 3,633,646	$ 3,252,607	$2,872,841
	Shareholders' Equity	$ 2,043,105	$ 1,792,586	$1,573,640
	Return on Average Shareholders' Equity *(2)*	19.4%	19.1%	19.1%

(1) Fiscal 1993 includes the $6,821,000 costs from the early redemption of the company's $100 million 9 1/2% sinking fund debentures, due 2016. Fiscal 1991 includes a $4,118,000 loss from the closing of the company's Memphis, Tennessee, distribution center. Fiscal 1989 includes a $6,114,000 loss on sale of manufacturing operations.

(2) In 1993, the company adopted two Statements of Financial Accounting Standards, No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" and No. 109 "Accounting for Income Taxes."

(3) Per share data have been adjusted for two-for-one stock splits in 1995 and 1991.

1993	1992	1991	1990	1989	1988	1987	1986
$8,294,840	$7,474,961	$6,733,044	$6,047,494	$5,380,133	$4,883,520	$4,281,606	$3,660,553
5,959,002	5,377,738	4,829,186	4,356,392	3,848,546	3,468,973	3,000,988	2,550,072
1,929,630	1,738,770	1,582,725	1,406,922	1,278,116	1,190,295	1,069,859	914,003
6,532	5,448	9,189	3,257	9,632	15,282	16,576	8,852
7,895,164	7,121,956	6,421,100	5,766,571	5,136,294	4,674,550	4,087,423	3,472,927
399,676	353,005	311,944	280,923	243,839	208,970	194,183	187,626
154,387	132,377	116,979	106,346	89,597	79,908	90,646	84,489
245,289	220,628	194,965	174,577	154,242	129,062	103,537	103,137
(23,623)	—	—	—	—	—	—	—
$ 221,666	$ 220,628	$ 194,965	$ 174,577	$ 154,242	$ 129,062	$ 103,537	$ 103,137
$ .99	$ .89	$ .79	$ .71	$ .63	$ .52	$ .42	$ .42
.90	.89	.79	.71	.63	.52	.42	.42
.30	.26	.23	.20	.17	.15	.14	.13
5.60	5.01	4.39	3.85	3.35	2.90	2.53	2.25
$ 6,210	$ 18,749	$ 122,960	$ 146,740	$ 150,121	$ 172,111	$ 141,433	$ 136,158
144,186	171,820	155,314	138,926	118,320	105,548	97,399	84,604
176,218	103,820	85,064	77,075	68,624	55,314	50,840	45,592
$2,506,034	$2,346,942	$2,074,359	$1,896,146	$1,666,322	$1,501,482	$1,354,217	$1,189,965
$1,378,751	$1,233,310	$1,081,157	$ 947,249	$ 823,401	$ 712,644	$ 622,328	$ 553,611
17.0%	19.1%	19.2%	19.7%	20.1%	19.3%	17.6%	19.9%

Results of Operations

Fiscal 1996 was the twenty-second consecutive year of record sales and earnings. Net earnings were $372 million or $1.50 per share, an increase of 15.9% from last year's earnings of $321 million or $1.30 per share. Earnings increases resulted from higher sales and improved expense ratios.

Total net sales increased by 13.3% to $11.8 billion in fiscal 1996 compared to increases of 12.6% in 1995 and 11.3% in 1994. Drugstore sales increases resulted from sales gains in existing stores and added sales from new stores, each of which include an indeterminate amount of market-driven price changes. Comparable drugstore (those open at least one year) sales were up 8.5% in 1996, 7.2% in 1995 and 5.5% in 1994. New store openings accounted for 7.6% of the sales gains in 1996 and 1995 and 7.4% in 1994. The company operated 2,193 drugstores as of August 31, 1996, compared to 2,085 a year earlier.

Prescription sales increased 18.0% in 1996, 19.8% in 1995 and 18.9% in 1994. Comparable drugstores were up 13.0%, 13.8% and 12.1% in 1996, 1995 and 1994, respectively. Prescription sales were 45.2% of total sales for fiscal 1996 compared to 43.4% in 1995 and 40.8% in 1994. Pharmacy sales trends are expected to continue primarily because of expansion into new markets, increased penetration in existing markets and demographic changes such as the aging population.

Gross margins as a percent of sales decreased to 27.7% of sales from 28.0% last year and 28.4% in fiscal 1994. Prescription margins continue to decrease as third party and mail service sales become larger portions of prescription sales. The company is responding to gross margin pressures by emphasizing minimum third party profitability standards.

The company uses the last-in, first-out (LIFO) method of inventory valuation. The effective LIFO inflation rates were .68% in 1996, 1.29% in 1995 and .3% in 1994, which resulted in charges to cost of sales of $12.8 million in 1996, $21.4 million in 1995 and $5.1 million in 1994. Inflation on prescription inventory was 2.3% in 1996 and 2.8% in both fiscal 1995 and 1994.

Selling, occupancy and administration expenses were 22.6% of sales in fiscal 1996, 23.0% of sales in fiscal 1995 and 23.4% of sales in fiscal 1994. The fiscal 1996 decrease, as a percent to sales, was caused by lower advertising expenses, insurance costs and improved accounts receivable collection experience. The fiscal 1995 decrease, as a percent to sales, was caused by store salaries, insurance and advertising.

Interest income was relatively constant over the three year periods. Average net investment levels were approximately $76 million in 1996, $59 million in 1995 and $105 million in 1994. The lower investment levels in fiscal 1996 and 1995 were offset by higher interest rates.

The fiscal 1996 and 1995 effective tax rates were 38.75% compared to 38.5% in 1994. The increases in rates compared to 1994 were due to higher state income taxes and estimated interest on tax audits.

Financial Condition

Cash and cash equivalents and marketable securities were $9 million at August 31, 1996, compared to $22 million at August 31, 1995. Short-term investment objectives are to maximize yields while minimizing risk and maintaining liquidity. To attain these objectives, investment limits are placed on the amount, type and issuer of securities.

Net cash provided by operating activities increased $66 million compared to the same period a year ago. This increase resulted primarily from higher earnings. The company's ongoing profitability is expected to continue as the principal source for providing expansion and remodeling programs, dividends to shareholders and funding for various technological improvements.

Net cash used for investing activities was $299 million for both fiscal 1996 and 1995. Additions to property and equipment were $365 million compared to $310 million last year. During the year, 210 new or relocated drugstores were opened which included five acquired locations. This compares to 206 new or relocated drugstores opened in the same period last year. New stores are owned or leased. There were 57 owned locations opened during the year or under construction at August 31, 1996 versus 17 for the same period last year. Capital expenditures for fiscal 1997 are expected to exceed $400 million. During the year, the company borrowed $82.2 million from corporate-owned life insurance policies. Sales of marketable securities provided $30.5 million last year.

The company expects to open at least 230 new stores in fiscal 1997, including units in the new markets of Detroit and Kansas City. Plans are to escalate new store openings to 300 per year beginning in 1998 and to be operating 3,000 stores across the country by the year 2000. This may necessitate future long-term borrowings. Intercom Plus, an advanced pharmacy computer and workflow system, is expected to be completed in fiscal 1997.

Net cash used for financing activities was $125 million for fiscal 1996 compared to $102 million for fiscal 1995. During both periods, the company obtained funds through the placement of commercial paper and repaid those borrowings. At August 31, 1996, the company had $132 million in unused bank lines of credit and $100 million of unissued authorized debt securities, previously filed with the Securities and Exchange Commission.

In fiscal 1995, the company received an unfavorable Tax Court ruling concerning the depreciable lives of certain assets. The company appealed, and on October 17, 1995, the United States Court of Appeals rendered an opinion which reversed the ruling. The case, which involves approximately $50 million of tax, including after-tax interest, was remanded back to the Tax Court for further findings which are in the process of being finalized. As of August 31, 1996, the company has adequately provided for the tax and related interest.

Financial Accounting Board Statement No. 123 "Accounting for Stock-Based Compensation" was issued in October 1995. This pronouncement will require the company to disclose the effect on income of stock options based on a formula outlined in the bulletin. This disclosure will be required in fiscal 1997. This pronouncement is not expected to materially impact the company's consolidated financial position or results of operations.

Consolidated Statements of Earnings and Retained Earnings

Walgreen Co. and Subsidiaries
For the Years Ended August 31, 1996, 1995 and 1994
(Dollars in Thousands, except per share data)

	Earnings	1996	1995	1994
Net Sales		$11,778,408	$10,395,096	$9,234,978
Costs and Deductions	Cost of sales	8,514,819	7,482,344	6,614,445
	Selling, occupancy and administration	2,659,525	2,392,731	2,164,889
		11,174,344	9,875,075	8,779,334
Other (Income) Expense	Interest income	(5,098)	(4,910)	(5,363)
	Interest expense	2,225	1,190	2,586
		(2,873)	(3,720)	(2,777)
Earnings	Earnings before income tax provision	606,937	523,741	458,421
	Income tax provision	235,188	202,950	176,492
	Net earnings	$ 371,749	$ 320,791	$ 281,929
Net Earnings per Common Share		$ 1.50	$ 1.30	$ 1.14

Retained Earnings	1996	1995	1994
Balance, beginning of year	$ 1,715,667	$ 1,496,721	$1,301,832
Net earnings	371,749	320,791	281,929
Cash dividends declared: $.44 per share in 1996, $.39 in 1995 and $.34 in 1994	(108,302)	(95,995)	(83,688)
Employee stock purchase and option plans	(12,928)	(5,850)	(3,352)
Balance, end of year	$ 1,966,186	$ 1,715,667	$1,496,721

The accompanying Statement of Major Accounting Policies and the Notes to Consolidated Financial Statements are integral parts of these statements.

Consolidated Balance Sheets

Walgreen Co. and Subsidiaries
At August 31, 1996 and 1995
(Dollars in Thousands)

	Assets	1996	1995
Current Assets	Cash and cash equivalents	$ 8,819	$ 22,245
	Accounts receivable	288,538	246,086
	Inventories	1,631,974	1,453,881
	Other current assets	89,707	90,705
	Total Current Assets	2,019,038	1,812,917
Non-Current Assets	Property and equipment, at cost, less accumulated depreciation and amortization	1,448,368	1,248,962
	Other non-current assets	166,240	190,728
	Total Assets	$3,633,646	$3,252,607

	Liabilities and Shareholders' Equity	1996	1995
Current Liabilities	Trade accounts payable	$ 691,836	$ 606,263
	Accrued expenses and other liabilities	467,359	448,219
	Income taxes	22,760	23,280
	Total Current Liabilities	1,181,955	1,077,762
Non-Current Liabilities	Deferred income taxes	145,218	142,278
	Other non-current liabilities	263,368	239,981
	Total Non-Current Liabilities	408,586	382,259
Shareholders' Equity	Preferred stock, $.25 par value; authorized 8,000,000 shares; none issued	—	—
	Common stock, $.3125 par value; authorized 800,000,000 shares; issued and outstanding 246,141,072 in 1996 and 1995, at stated value	76,919	76,919
	Retained earnings	1,966,186	1,715,667
	Total Shareholders' Equity	2,043,105	1,792,586
	Total Liabilities and Shareholders' Equity	$3,633,646	$3,252,607

The accompanying Statement of Major Accounting Policies and the Notes to Consolidated Financial Statements are integral parts of these statements.

Consolidated Statements of Cash Flows

Walgreen Co. and Subsidiaries
For the Years Ended August 31, 1996, 1995 and 1994
(Dollars in Thousands)

	Fiscal Year	1996	1995	1994
Cash Flows from Operating Activities	Net earnings	$ 371,749	$ 320,791	$ 281,929
	Adjustments to reconcile net earnings to net cash provided by operating activities –			
	Depreciation and amortization	147,311	131,537	118,118
	Deferred income taxes	2,992	(7,213)	5,653
	Other	4,619	3,388	15,983
	Changes in operating assets and liabilities –			
	Inventories	(178,093)	(190,481)	(169,365)
	Trade accounts payable	85,573	73,447	105,631
	Accounts receivable	(60,011)	(36,265)	(50,692)
	Accrued expenses and other liabilities	42,091	41,669	35,051
	Income taxes	(8,820)	905	693
	Insurance reserves	2,910	14,982	16,797
	Other current assets	946	(7,807)	(3,910)
	Net cash provided by operating activities	411,267	344,953	355,888
Cash Flows from Investing Activities	Additions to property and equipment	(364,586)	(310,254)	(289,976)
	Net borrowing against (investment in) corporate-owned life insurance	47,370	(34,140)	(6,445)
	Net proceeds from (purchases of) marketable securities	—	30,510	(815)
	Disposition of property and equipment	17,869	15,242	13,704
	Net cash used for investing activities	(299,347)	(298,642)	(283,532)
Cash Flows from Financing Activities	Cash dividends paid	(105,225)	(92,918)	(81,226)
	Cost of employee stock purchase and option plans	(12,928)	(5,850)	(3,352)
	(Purchases for) proceeds from employee stock plans	(6,757)	3,916	4,300
	Payments of long-term obligations	(436)	(7,129)	(5,760)
	Net cash used for financing activities	(125,346)	(101,981)	(86,038)
Changes in Cash and Cash Equivalents	Net decrease in cash and cash equivalents	(13,426)	(55,670)	(13,682)
	Cash and cash equivalents at beginning of year	22,245	77,915	91,597
	Cash and cash equivalents at end of year	$ 8,819	$ 22,245	$ 77,915

The accompanying Statement of Major Accounting Policies and the Notes to Consolidated Financial Statements are integral parts of these statements.

Statement of Major Accounting Policies

Description of Business

The company is principally in the retail drugstore business. Stores are located in 34 states and Puerto Rico. At August 31, 1996, there were 2,191 retail drugstores and two mail service facilities. Prescription sales were 45.2% of total sales for fiscal 1996 compared to 43.4% in 1995 and 40.8% in 1994. Prescription sales continue to grow and become a larger portion of the company's business.

Basis of Presentation

The consolidated statements include the accounts of the company and its subsidiaries. All significant intercompany transactions have been eliminated. The financial statements are prepared in accordance with generally accepted accounting principles and include amounts based on management's most prudent judgments and estimates. Actual results may differ from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and all highly liquid investments with an original maturity of three months or less. All other temporary investments are classified as marketable securities.

The company's cash management policy provides for the bank disbursement accounts to be reimbursed on a daily basis. Checks issued but not presented to the banks for payment of $143,000,000 and $130,000,000 at August 31, 1996 and 1995, respectively, are included in cash and cash equivalents as reductions of other cash balances.

Financial Instruments

The company had approximately $12,000,000 and $18,000,000 of outstanding letters of credit at August 31, 1996 and 1995, respectively, which guaranteed foreign trade purchases. Additional outstanding letters of credit of $59,000,000 at August 31, 1996 and $57,000,000 at August 31, 1995 were related to insurance activities. The company also has purchase commitments of approximately $68,000,000 and $17,000,000 at August 31, 1996 and 1995, respectively, related to the purchase of store locations. There were no investments in derivative financial instruments during fiscal 1996 and 1995.

Inventories

Inventories are valued on a lower of last-in, first-out (LIFO) cost or market basis. At August 31, 1996 and 1995, inventories would have been greater by $427,767,000 and $415,015,000, respectively, if they had been valued on a lower of first-in, first-out (FIFO) cost or market basis. Cost of sales is primarily computed on an estimated basis and adjusted based on periodic inventories.

Long-Lived Assets

In fiscal 1996 the company adopted Financial Accounting Board Statement No. 121 "Accounting for the Impairment of Long-Lived Assets." This pronouncement, which was adopted early, requires long-lived assets to be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. No material effect on the financial statements occurred due to the previous existing accounting policy conforming in all material aspects to the new standard.

Property and Equipment

Depreciation is provided on a straight-line basis over the estimated useful lives of owned assets. Leasehold improvements and leased properties under capital leases are amortized over the estimated physical life of the property or over the term of the lease, whichever is shorter. Major repairs which extend the useful life of an asset are capitalized in the property and equipment accounts. Routine maintenance and repairs are charged against earnings. The composite method of depreciation is used for equipment; therefore, gains and losses on retirement or other disposition of such assets are included in earnings only when an operating location is closed, completely remodeled or impaired resulting in the carrying amount not being recoverable. Fully depreciated property and equipment are removed from the cost and related accumulated depreciation and amortization accounts.

Property and equipment consists of *(In Thousands)*:

	1996	1995
Land and land improvements	$ 128,772	$ 88,097
Buildings and building improvements	619,712	555,645
Equipment	1,197,352	1,047,548
Capitalized systems development costs	141,732	117,545
Capital lease properties	19,969	21,930
	2,107,537	1,830,765
Less: accumulated depreciation and amortization	659,169	581,803
	$1,448,368	$1,248,962

The company capitalizes significant systems development costs. These costs are amortized over a five-year period as phases of these systems are implemented. Unamortized costs as of August 31, 1996 and 1995, were $98,409,000 and $84,910,000, respectively. Amortization of these costs were $10,688,000, $11,053,000 and $8,901,000 in 1996, 1995 and 1994, respectively.

Income Taxes

The company provides for federal and state income taxes on items included in the Consolidated Statements of Earnings regardless of the period when such taxes are payable. Deferred taxes are recognized for temporary differences between financial and income tax reporting based on enacted tax laws and rates.

Retirement Benefits

The principal retirement plan for employees is the Walgreen Profit-Sharing Retirement Trust, to which both the company and the employees contribute. The company's contribution, which is determined annually at the discretion of the Board of Directors, has historically related to pretax income. The profit-sharing provision was $50,386,000 in 1996, $44,315,000 in 1995 and $37,683,000 in 1994.

The company provides certain health and life insurance benefits for retired employees who meet eligibility requirements, including age and years of service. The costs of these benefits are accrued over the period earned. The company's postretirement benefit plans currently are not funded.

The company has deferred compensation plans which permit directors and certain management employees the right to defer a portion of their compensation. The participants earn interest on deferred amounts depending on various factors defined in the plans. Although not linked to the plans, the company has purchased life insurance on the participants and other key employees to fund the distributions under these and other benefit plans.

Net Earnings Per Common Share

Primary net earnings per share were computed using weighted average number of shares and common share equivalents outstanding of 248,436,005 in 1996, 247,527,030 in 1995 and 247,292,458 in 1994. Fully diluted net earnings per share are the same as primary net earnings per share.

Pre-Opening Expenses

Non-capital expenditures incurred prior to the opening of a new or remodeled store are charged against earnings when they are incurred.

Advertising Costs

Advertising costs are expensed as incurred, and were $82,360,000 in 1996, $85,907,000 in 1995 and $93,467,000 in 1994.

Notes to Consolidated Financial Statements

Interest Expense

The company capitalized $254,000, $751,000 and $482,000 of interest expense as part of significant construction projects during fiscal 1996, 1995 and 1994, respectively. Interest paid, net of amounts capitalized, was $2,702,000 in 1996, $2,950,000 in 1995 and $1,954,000 in 1994.

Leases

Although some locations are owned, the company generally operates in leased premises. Original non-cancelable lease terms typically are 20 years and may contain escalation clauses, along with options that permit renewals for additional periods. The total amount of the minimum rent is expensed on a straight-line basis over the term of the lease. In addition to minimum fixed rentals, most leases provide for contingent rentals based upon sales.

Minimum rental commitments at August 31, 1996, under all leases having an initial or remaining non-cancelable term of more than one year are shown below *(In Thousands)*:

Year	
1997	$ 325,083
1998	345,140
1999	326,756
2000	315,165
2001	300,713
Later	3,119,089
Total minimum lease payments	$4,731,946

The above minimum lease payments include minimum rental commitments related to capital leases amounting to $13,072,000 at August 31, 1996. The present value of net minimum capital lease payments, due after 1997, are reflected in the accompanying Consolidated Balance Sheets as part of other non-current liabilities. Total minimum lease payments have not been reduced by minimum sublease rentals of approximately $14,270,000 on leases due in the future under non-cancelable subleases.

Rental expense was as follows *(In Thousands)*:

	1996	1995	1994
Minimum rentals	$317,993	$279,217	$242,637
Contingent rentals	35,492	34,707	34,107
Less: Sublease rental income	(2,932)	(2,845)	(2,707)
	$350,553	$311,079	$274,037

Income Taxes

The provision for income taxes consists of the following *(In Thousands)*:

	1996	1995	1994
Current provision –			
Federal	$196,216	$177,023	$145,381
State	35,980	33,140	25,458
	232,196	210,163	170,839
Deferred provision –			
Federal	2,825	(6,025)	3,881
State	167	(1,188)	1,772
	2,992	(7,213)	5,653
	$235,188	$202,950	$176,492

The components of the deferred provision were *(In Thousands)*:

	1996	1995	1994
Employee benefit plans	$ (14,793)	$ (9,154)	$ (6,956)
Accelerated depreciation	12,446	10,191	20,756
Insurance	1,101	(5,451)	(2,763)
Other	4,238	(2,799)	(5,384)
	$ 2,992	$ (7,213)	$ 5,653

The deferred tax assets and liabilities included in the Consolidated Balance Sheet as of August 31, 1996, consist of the following *(In Thousands)*:

	Assets	Liabilities	Total
Current –			
Employee benefit plans	$ 36,614	$ (6,983)	$ 29,631
Inventory	14,761	(33,018)	(18,257)
Insurance	11,638	—	11,638
Allowances for doubtful accounts	6,045	—	6,045
Other	15,217	(3,782)	11,435
	84,275	(43,783)	40,492
Non-current –			
Accelerated depreciation	—	(253,220)	(253,220)
Employee benefit plans	46,614	—	46,614
Insurance	28,597	—	28,597
Other	33,117	(326)	32,791
	108,328	(253,546)	(145,218)
	$192,603	$(297,329)	$(104,726)

Income taxes paid were $241,016,000, $209,258,000 and $170,146,000 during the fiscal years ended August 31, 1996, 1995 and 1994, respectively. The difference between the statutory income tax rate and the effective tax rate is principally due to state income tax provisions.

Short-Term Borrowings

At August 31, 1996, the company had approximately $132,000,000 of available bank lines of credit. The credit lines are renewable annually at various dates and provide for loans of varying maturities at the prime rate. There are no compensating balance arrangements.

The company obtained funds through the placement of commercial paper, as follows *(Dollars in Thousands)*:

	1996	1995	1994
Average outstanding during the year	$19,327	$ 5,996	$ 2,011
Largest month-end balance	77,289 (Nov)	35,000 (Nov)	12,977 (Nov)
Weighted average interest rate	5.8%	5.5%	3.3%

Contingencies

The company is involved in various legal proceedings incidental to the normal course of business. Company management is of the opinion, based upon the advice of General Counsel, that although the outcome of such litigation cannot be forecast with certainty, the final disposition should not have a material adverse effect on the company's consolidated financial position or results of operations.

Capital Stock

The company's common stock is subject to a Rights Agreement under which each share has attached to it a Right to purchase one one-hundredth of a share of a new series of Preferred Stock, at a price of $150.00 per Right, in the event a person or group acquires or attempts to acquire 15% of the then outstanding shares of the company. In the event that a person or group acquires 15% or more of the outstanding common stock of the company (other than in certain instances as defined in the Rights Agreement), each Right, except those of an Acquiring Person, would entitle the holder to purchase a number of shares of the company's common stock which number is determined pursuant to a formula contained in the Rights Agreement. The Rights, which are non-voting, will expire on August 21, 2006, but may be redeemed by the company at a price of $.01 per Right at any time prior to a public announcement that 15% or more of the company's common stock has been acquired.

As of August 31, 1996, 25,818,064 shares of common stock were reserved for future stock issuances under the company's employee stock purchase, option and award plans. Preferred stock of 2,462,120 shares have been reserved for issuance upon the exercise of Preferred Share Purchase Rights.

Stock Option Plans

The Walgreen Co. Executive Stock Option Plan provides for the granting to key employees of options to purchase company common stock over a 10-year period, at a price not less than the fair market value on the date of grant. Options may be issued under the Plan until October 13, 2002, for an aggregate of 9,600,000 shares of common stock of the company. The number of shares available for future grant was 1,825,750 and 1,913,090 at August 31, 1996 and 1995, respectively.

The Walgreen Co. Stock Purchase/Option Plan (Share Walgreens) provides for the granting of options to eligible employees upon the purchase of company shares subject to certain restrictions. Under the terms of the plan, the option price cannot be less than 85% of the fair market value at the date of the grant. Compensation expense related to the plan was $100,000, $314,000 and $986,000 in 1996, 1995 and 1994, respectively. Options may be issued under this plan until September 30, 2002, for an aggregate of 10,000,000 shares of common stock of the company. The number of shares available for future grant was 7,683,413 and 7,723,712 at August 31, 1996 and 1995, respectively. The options granted during 1994 through 1996 have a two-year holding period.

Stock option transactions in fiscal 1994, 1995 and 1996 are summarized as follows:

	Shares	*Per Share Option Price*	*Exercisable*
Outstanding August 31, 1993	5,500,244	$ 4.203–$20.188	1,930,772
Granted	449,520	18.688– 20.875	
Exercised	(223,696)	4.203– 19.250	
Cancelled and expired	(70,538)	7.219– 19.750	
Outstanding August 31, 1994	5,655,530	$ 6.172–$20.875	2,018,828
Granted	2,114,590	18.813– 23.750	
Exercised	(231,794)	6.172– 19.250	
Cancelled and expired	(60,516)	11.406– 19.750	
Outstanding August 31, 1995	7,477,810	$ 6.563–$23.750	4,686,171
Granted	149,568	24.500– 33.500	
Exercised	(379,150)	6.563– 19.750	
Cancelled and expired	(21,424)	18.813– 19.750	
Outstanding August 31, 1996	7,226,804	$ 6.625–$33.500	5,370,798

Postretirement Benefits

The components of postretirement benefit cost for fiscal 1996, 1995 and 1994 were as follows *(In Thousands)*:

	1996	**1995**	**1994**
Service costs – benefits earned during the year	$4,130	$3,781	$2,859
Interest cost on accumulated postretirement benefit obligation	5,788	5,576	4,638
Amortization of unrecognized actuarial amount	79	229	271
Total postretirement benefit cost	$9,997	$9,586	$7,768

The company's unfunded accumulated postretirement benefit liability at August 31, included in the Consolidated Balance Sheets were as follows *(In Thousands)*:

	1996	**1995**
Retirees	$21,696	$20,210
Fully eligible active plan participants	11,036	9,834
Other active plan participants	48,396	45,747
Accumulated postretirement benefit obligation	81,128	75,791
Unrecognized actuarial amount	19	(1,820)
Accrued postretirement benefit liability	$81,147	$73,971

The accumulated postretirement benefit obligation was determined assuming the discount rate was 7.75% and the healthcare cost trend rate was 7.0% for 1996, with a gradual decline over a 13-year period to 4.5%. These trend rates reflect the company's prior experience and management's expectation that future rates will decline. The effect of a 1% increase each year in the projected healthcare cost trend rate would increase the accumulated postretirement benefit obligation at August 31, 1996 by $15,027,000 and the service and interest cost components of the fiscal 1996 net periodic postretirement benefit cost by $2,905,000. The unrecognized actuarial amount is being amortized over the average remaining service period of active plan participants.

Supplementary Financial Information

Included in the Consolidated Balance Sheets captions are the following assets and liabilities *(In Thousands)*:

	1996	**1995**
Accounts receivable –		
Accounts receivable	$303,014	$270,719
Allowances for doubtful accounts	(14,476)	(24,633)
	$288,538	$246,086
Other non-current assets –		
Cash surrender value of life insurance, net of borrowings	$133,522	$166,719
Other	32,718	24,009
	$166,240	$190,728
Accrued expenses and other liabilities –		
Accrued salaries	$137,032	$139,438
Taxes other than income taxes	74,511	63,169
Profit sharing	73,592	60,094
Other	182,224	185,518
	$467,359	$448,219
Other non-current liabilities –		
Insurance	$ 79,704	$ 73,733
Postretirement benefit obligation	78,347	71,370
Accrued rent	56,737	50,482
Deferred compensation	26,098	23,667
Deferred income	12,368	10,401
Obligations under capital leases	6,711	7,933
Long-term debt, net of current maturities	3,403	2,395
	$263,368	$239,981

Long-term debt includes notes and other real estate obligations with interest rates ranging from 6.25% to 8.75%. Annual maturities due on long-term debt are $431,000, $462,000, $488,000, $91,000 and $98,000 for fiscal 1997 through 2001, respectively.

Report of Independent Public Accountants

To the Board of Directors and Shareholders of Walgreen Co.:

We have audited the accompanying consolidated balance sheets of Walgreen Co. (an Illinois corporation) and Subsidiaries as of August 31, 1996 and 1995, and the related consolidated statements of earnings, retained earnings and cash flows for each of the three years in the period ended August 31, 1996. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Walgreen Co. and Subsidiaries as of August 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended August 31, 1996 in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Chicago, Illinois,
September 27, 1996

Management's Report

The primary responsibility for the integrity and objectivity of the consolidated financial statements and related financial data rests with the management of Walgreen Co. The financial statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances and included amounts that were based on management's most prudent judgments and estimates relating to matters not concluded by fiscal year-end. Management believes that all material uncertainties have been either appropriately accounted for or disclosed. All other financial information included in this annual report is consistent with the financial statements.

The firm of Arthur Andersen LLP, independent public accountants, was engaged to render a professional opinion on Walgreen Co.'s consolidated financial statements. Their report contains an opinion based on their audit, which was made in accordance with generally accepted auditing standards and procedures, which they believed were sufficient to provide reasonable assurance that the consolidated financial statements, considered in their entirety, are not misleading and do not contain material errors.

Three outside members of the Board of Directors comprise the company's Audit Committee, which meets at least quarterly and is responsible for reviewing and monitoring the company's financial and accounting practices. In order to insure and maintain complete independence, Arthur Andersen LLP and the company's General Auditor have access to meet alone with the Audit Committee, which also meets with the company's management to discuss financial matters, auditing and internal accounting controls.

The company's systems are designed to provide an effective system of internal accounting controls to obtain reasonable assurance at reasonable cost that assets are safeguarded from material loss or unauthorized use and transactions are executed in accordance with management's authorization and properly recorded. To this end, management maintains an internal control environment which is shaped by established operating policies and procedures, an appropriate division of responsibility at all organizational levels, and a corporate ethics policy which is monitored annually. The company also has an Internal Control Evaluation Committee, comprised primarily of senior management from the Accounting and Auditing Departments, which oversees the evaluation of internal controls on a company-wide basis. Management believes it has appropriately responded to the internal auditors' and independent public accountants' recommendations concerning the company's internal control system.

C. R. Walgreen III

C. R. Walgreen III
Chairman of the Board
and Chief Executive Officer

R. H. Clausen

R. H. Clausen
Controller
and Chief Accounting Officer

R. L. Polark

R. L. Polark
Senior Vice President
and Chief Financial Officer

The Walgreen Year...A Review by Quarters *(Unaudited)*

Summary of Quarterly Results, Fiscal 1996 and 1995
(Dollars in Thousands, except per share data)

		Quarter Ended				
		November	February	May	August	Fiscal Year
Fiscal 1996	Net sales	$2,692,767	$3,179,089	$2,988,836	$2,917,716	$11,778,408
	Gross profit	738,982	889,286	823,224	812,097	3,263,589
	Net earnings	63,655	126,801	91,575	89,718	371,749
	Net earnings per common share	$ .26	$ .51	$ .37	$ .36	$ 1.50
Fiscal 1995	Net sales	$2,405,556	$2,806,984	$2,617,368	$2,565,188	$10,395,096
	Gross profit	664,792	797,861	729,122	720,977	2,912,752
	Net earnings	53,994	111,557	78,990	76,250	320,791
	Net earnings per common share	$ .22	$ .45	$ .32	$ .31	$ 1.30

Comments on Quarterly Results

In further explanation of and supplemental to the quarterly results, the 1996 fourth quarter LIFO adjustment was a credit of $4,839,000 compared to a 1995 credit of $3,350,000. If the 1996 and 1995 interim results were adjusted to reflect the actual inventory inflation rates and inventory levels as computed at year end, earnings per share would have been higher in each of the first two quarters by $.01, and lower in the fourth quarter by $.02.

Board of Directors

Directors

Charles R. Walgreen III
Chairman of the Board and
Chief Executive Officer
Elected 1963

Theodore Dimitriou
Chairman of the Board,
Wallace Computer Services, Inc.
Elected 1986
Retiring in January 1997

James J. Howard
Chairman of the Board,
Chief Executive Officer and
President,
Northern States Power Company
Elected 1986

Charles D. Hunter
Former Vice Chairman and
Chief Financial Officer
Elected 1974

L. Daniel Jorndt
President and Chief
Operating Officer
Elected 1990

Cordell Reed
Senior Vice President,
Commonwealth Edison Co.
Elected 1994

John B. Schwemm
Former Chairman and
Chief Executive Officer,
R.R. Donnelley & Sons Co.
Elected 1985

William H. Springer
Former Vice Chairman,
Ameritech Corporation
Elected 1988

Marilou M. von Ferstel
Executive Vice President and
General Manager,
Ogilvy Adams & Rinehart
Elected 1987

Committees

Executive Committee
Charles R. Walgreen III,
Chairman
Theodore Dimitriou
Charles D. Hunter
L. Daniel Jorndt
John B. Schwemm

Audit Committee
Theodore Dimitriou,
Chairman
John B. Schwemm
Marilou M. von Ferstel

Compensation Committee
William H. Springer,
Chairman
James J. Howard
John B. Schwemm

Finance Committee
Charles D. Hunter,
Chairman
L. Daniel Jorndt
Cordell Reed
Charles R. Walgreen III

Nominating and Governance Committee
John B. Schwemm,
Chairman
James J. Howard
Marilou M. von Ferstel

Officers

Corporate

Chairman
Charles R. Walgreen III
Chief Executive Officer

President
L. Daniel Jorndt
Chief Operating Officer

Executive Vice Presidents
Vernon A. Brunner
Marketing
Glenn S. Kraiss
Store Operations

Senior Vice Presidents
David W. Bernauer
Chief Information Officer
Roger L. Polark
Chief Financial Officer
John A. Rubino
Human Resources
William A. Shiel
Facilities Development

Vice Presidents
Robert C. Atlas
Eastern Store Operations
W. Lynn Earnest
Central Store Operations
Robert H. Halaska
President,
WHP Health Initiatives
Jerome B. Karlin
Western Store Operations
J. Randolph Lewis
Distribution & Logistics
Julian A. Oettinger
General Counsel,
Corporate Secretary

Regional Vice Presidents
Drug Store Division
Enrique F. Anglade
George C. Eilers
Patrick E. Hanifen
Barry L. Markl
Robert G. McKillop
Richard J. McMillin
Richard L. Moyer
Richard Robinson
Bill J. Vernon
Kevin P. Walgreen
Edward E. Williams
Bruce C. Zarkowsky

Divisional Vice Presidents
Roger H. Clausen
Controller
John W. Gleeson
Marketing Systems
and Services
Don R. Holman
Purchasing/Merchandising
Joel H. Levin
Tax
Mark R. Paul
Purchasing/Merchandising
Jeffrey A. Rein
Treasurer
Craig M. Sinclair
Corporate Advertising
William G. Thien
Health Services
Chester G. Young
General Auditor

Assistant Secretaries
Nancy J. Godfrey
Dana I. Green
Edward H. King
Joel H. Levin
Allan M. Resnick

Assistant Treasurers
Richard C. Hildebrandt
John M. Palizza

Drugstore Unit and Sales Overview

	Fiscal Year	1996	1995	1994	1993	1992
Drugstore Units	Openings					
	New Stores	205	202	194	149	124
	Acquisitions	5	4	2	0	4
	Remodelings	71	84	70	138	118
	Closings	102	89	64	49	38
	Year End: Units *(1)*	2,193	2,085	1,968	1,836	1,736
	Year End: Sales Area *(2)*	22,124	20,731	19,342	17,950	16,811
Product Class Sales	Prescription Drugs	45%	43%	41%	38%	37%
	Nonprescription Drugs *(3)*	13	13	13	14	14
	Cosmetics, Toiletries *(3)*	8	8	9	9	9
	General Merchandise *(3)*	24	24	24	25	25
	Tobacco Products *(3)*	3	4	4	4	4
	Liquor, Beverages	7	8	9	10	11

(1) Includes 24 RxPress units and two mail service facilities.
(2) In thousands of square feet.
(3) Estimates based, in part, on store scanning information.

Shareholder Information

Corporate Headquarters
Walgreen Co.
200 Wilmot Road
Deerfield, Illinois 60015
(847) 940-2500

Shareholder Communications
Please address inquiries or comments to:
Shareholder Relations
Walgreen Co. - Mail Stop #2261
200 Wilmot Road
Deerfield, Illinois 60015
(847) 914-2972

The company's annual report to the Securities and Exchange Commission, Form 10-K, may be obtained by any shareholder, free of charge, upon written request.

Quarterly Reports
Walgreens mails quarterly reports on request. Please contact Shareholder Relations if you wish to be added to – or deleted from – the quarterly mailing list, or if you are receiving unwanted multiple copies of annual or quarterly reports.

Internet Address
Major press releases and other information are available on Walgreens Internet home page: *http://www.walgreens.com*

Transfer Agent and Registrar
Harris Trust and Savings Bank
Shareholder Services
311 West Monroe Street, 11th Floor
Chicago, Illinois 60690

Annual Shareholders' Meeting
You are cordially invited to attend the meeting to be held Wednesday, January 8, 1997, 2 p.m. in the Arthur Rubloff Auditorium, The Art Institute, Chicago, Illinois.

For the first time, we will offer a sign language interpreter for the hearing-impaired. If you would like to take advantage of this service, please watch for a sign directing you to a special area at The Art Institute.

Formal notice of the meeting, with proxy card and proxy statement, was mailed to all shareholders of record as of November 12, 1996.

Stock Market Listings
New York Stock Exchange
Chicago Stock Exchange
Symbol: WAG

Investor Contacts
John M. Palizza
Jeffrey A. Rein

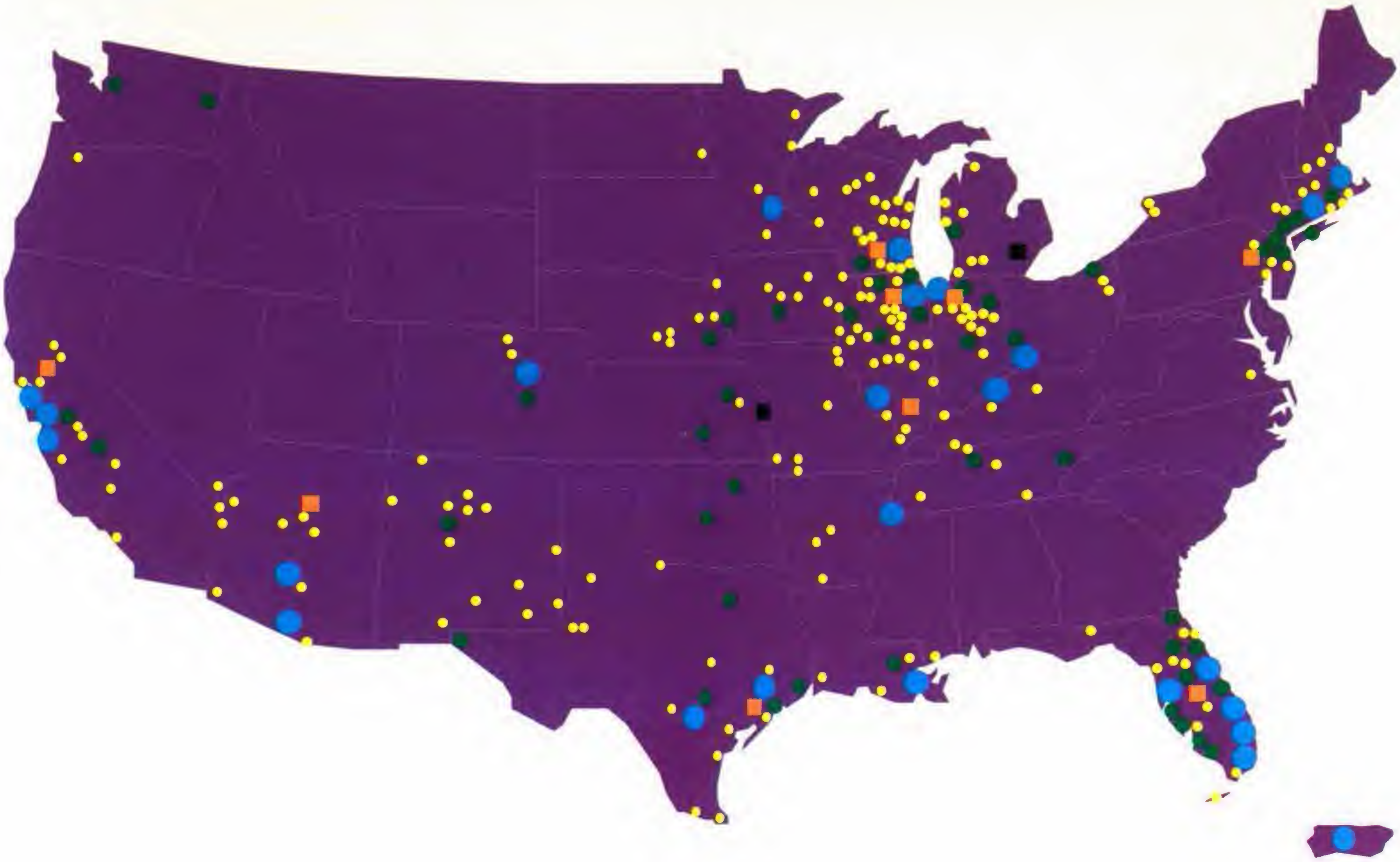
Dividend Payment Dates
Walgreens pays dividends in March, June, September and December. Checks are customarily mailed on approximately the 12th of each of these months.

Dividend Reinvestment Plan
Automatic Dividend Reinvestment allows Walgreen shareholders to authorize that dividend payments be used to purchase additional Walgreen stock. Purchase expenses are company-paid. Withdrawal is optional at any time. The plan's cash investment option allows voluntary contributions of up to $5,000 per quarter. For an information booklet and authorization form, please write to: Shareholder Relations, Walgreen Co.

The publication "Walgreen People at Work – 1996" is available by request. Please write to: Employee Relations Department, Corporate Headquarters.

Printed on Recycled Paper

Design: Cagney + McDowell, Inc., Chicago   Photography: Michael Mauney, Chicago



Walgreens Nationwide

State	1996	1995
Arizona	128	120
Arkansas	8	9
California	139	131
Colorado	49	50
Connecticut	32	31
Florida	370	344
Illinois	318	316
Indiana	103	102
Iowa	30	30
Kansas	15	15
Kentucky	36	35
Louisiana	48	46

State	1996	1995
Massachusetts	71	67
Michigan	26	26
Minnesota	61	60
Mississippi	5	5
Missouri	71	68
Nebraska	29	30
Nevada	2	0
New Hampshire	8	8
New Jersey	37	31
New Mexico	36	36
New York	26	26
North Dakota	1	1

State	1996	1995
Ohio	56	52
Oregon	1	0
Oklahoma	19	10
Pennsylvania	2	1
Rhode Island	7	5
Tennessee	76	76
Texas	213	199
Virginia	2	0
Washington	12	5
Wisconsin	114	110
Puerto Rico	42	40
Total	**2,193**	**2,085**

25 stores or more
6 to 24 stores
1 to 5 stores
Distribution Centers
New markets: Detroit and Kansas City

Information is provided as of fiscal year-end.

Thanks for Taking the Time and Remember...

"You're Always Welcome at Walgreens."

Walgreens

The Pharmacy America Trusts

Walgreen Co.
200 Wilmot Road
Deerfield, Illinois 60015